

# Defense Affordability – Expensive Contracting Policies



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# “Commercial” Companies and DoD Business

- Non-Government commercial companies find it virtually impossible to do business with DoD, other than for the sale of off-the-shelf commercial products.
- Selling to the Government on a sole source or flexibly priced contract entails so many non-commercial type, expensive rules, that even largely “commercial” companies, such as Fluor or Boeing, create separate organizational entities that only sell to the Government.
- Companies that specialize in DoD work, cannot be competitive in “commercial” sales because of the expensive administrative systems they have been forced to implement.

# Status of Government Contracting

- Wide policy swings, often driven by political changes or isolated incidents of perceived contractor wrongdoing, have made the procurement process increasingly difficult and complex.
- New Government procurement regulations unlike standard business practices followed in commercial transactions on which the original FAR was based. (e.g., “Business Systems” rule, limits on reimbursability of executive compensation.)
- Increased bureaucracy. As a new VP for Fluor contracts, I waited over 2 weeks to schedule an introductory courtesy meeting with a military contracting official while his staff processed my written “application” for the visit.
- Washington Post indicates new businesses receiving federal contracts declined 14% in FY2011 – from 34,800 in 2010 to 29,800 in 2011.

# Expensive New Government Policy – Business Systems Rule

- ◆ Business systems are purchasing, property management, cost estimating, EVMS, MMAS, accounting systems.
- ◆ Will require more contractor personnel to prove these systems meet all Government requirements. Will require more audits of the systems. Withholding of payments permitted on all types of contracts, even those where Government does not withhold for failure to meet performance requirements. Alternative is to use Sarbanes Oxley requirements to certify business systems for publicly traded firms.
- ◆ In the commercial world, does the customer audit the business systems of the seller? If the product meets requirements, are there withholdings from the price for business systems non-compliance?

# Expensive Policies - EVM

- In a 2010 Grant Thornton survey of Government contractors, 25% of companies required to report under EVMS would adopt if they were not required to do so by the contract.
- DoD should relook at the cost effectiveness of full EVM implementation, and the cost of traveling Government teams who evaluate EVM systems.
- Should the scale of EVM implementation be scoped back?

# DCAA Issues - Background

- ◆ GAO issued 2 reports in 2008 finding that DCAA did not follow Generally Accepted Government Accounting Standards (GAGAS) on 14 audits.
  - Contractors and DoD contracts personnel improperly influenced audit scope, conclusions and opinions.
  - Working papers did not support reported opinions.
  - Supervisors changed opinions without evidence for changes.

# DCAA Reaction

- ◆ 8/08 – Discontinued participation in IPTs including proposal pricing and negotiation IPTs. Refuse to adhere to requested timeframes for assist audits.
- ◆ 12/08 – Imposed rigorous timelines for contractor responses to auditor requests for records and access to contractor personnel. Also, an auditor may no longer find contractor control systems inadequate “in part,” and must suspend payment of invoices if a control objective not met.
- ◆ 3/09 – Stated certain unsatisfactory conditions related to actions of Government officials to be reported to DoDIG, e.g. contracting officer ignores audit report and awards at “excessive” costs.

## DCAA Reaction (continued)

- ◆ 4/09 – Stated that if a billing system, or an accounting system that affects the billing system, has been significantly modified or a new system implemented, direct billing authority will be rescinded and will not be restored until DCAA determines the new system is adequate.
- ◆ 7/09 – Proposes automatic withholding of 10% or more whenever a control system is found inadequate.
- ◆ New DCAA policies delaying acquisition process by making DCAA less responsive and by having a chilling effect on contracting officers' willingness to negotiate settlements of complex issues.

# DCAA - Impact

- ◆ Enormous demands for cost data – especially subcontract data, on negotiated contracts.
- ◆ Issuance of numerous “Form 1” final decisions, with contracting officers reluctant to overrule DCAA.
- ◆ Protracted negotiation schedules, exacerbated by long waits for DCAA reports.
- ◆ DCAA questioning small amounts of cost, with contractors having to spend resources to research responses. Implementing a \$1,000 threshold for questioning cost would cut the use of resources substantially and would entail minimal risk for Government.
- ◆ While DCAA is employing resources on other matters, negotiation of forward pricing and final pricing rates has languished. (Fluor does not have final negotiated rates since 1995). Result has been each contracting officer negotiating contract specific rates and inability to close thousands of open contracts.

# Other Expensive Policies

- ◆ Rule requiring separate calculations and negotiations to receive “preferred” performance based contract payments.
- ◆ Imposition of CAS 401 and 402 (consistency standards) on foreign entities. This will result in prime contractors and DCAA having to expend resources to try to implement U.S. cost accounting standards on foreign contractors.
- ◆ Peer reviews – Contracting personnel should be capable of writing and negotiating contracts and running source selections. Routine outside reviews ought not be necessary.
- ◆ Elimination of contractors from competitions for proposing less expensive alternate solutions. RFPs frequently disqualify contractors from proposing alternatives.

# Other Expensive Policies

- ◆ Imposing FPI contracts as the norm without assessing the administration costs of such contracts and the complexity of closing them.
- ◆ Disclosing to the CO and IG, and Government investigating disclosures of single digit mischarging under Mandatory Disclosure law, instead of just correcting the mischarging. 50% of disclosures are company discovered instances of mischarging.

# Profit

- ◆ Some DoD policy promulgations appear aimed at reducing contractor profits as a way of promoting affordability. Government Contracting is not a high profit business.
- ◆ 2011 Grant Thornton study of Government contractors reports:
  - 31% of participants reported profit rates of 1–5% as a percentage of revenue (up from 31% in 2009)
  - 37% saw profit rates of 6–10%.
  - 18% reported profit rates of 11–15%.
  - 8% had profit rates above 15%.
  - 6% did not make a profit or had a loss.

37% of government contractors did not make a profit, experienced a loss, or posted a profit at 1–5% of revenue.

# Expensive Processes – Resolving Issues

## ♦ In 2011 Grant Thornton study,

- 19% rated relationship with auditors as fair or poor (compared with 11% in 2010).
- 10% rated relationship with contracting officers as fair or poor (compared with 5% in 2010).

## ♦ Lengthening times to settle issues with auditors and contracting officers drives up costs.

# Summary

Government policy makers should:

- Refrain from increasing the complexity of contracting rules.
- Roll back clauses and policy that direct contractor focus away from providing a product or service and more toward perfecting its business systems.
- Cease recent policy encouragement to reduce profits everywhere.
- Reconsider cost effectiveness of rigid implementation of EVM.
- Evaluate whether DCAA recommendations taking precedence over PCO and DCMA judgment is an effective use of resources.